

57  
178  
v.1

Oak Street  
UNCLASSIFIED

# INDIA AND THE COMMONWEALTH

PART I

POLITICAL AND STRATEGIC



BY

K. P. KARUNAKARAN

PREPARED FOR THE  
COMMONWEALTH RELATIONS CONFERENCE  
1954

LAHORE

Distributed in the United States by  
**INSTITUTE OF PACIFIC RELATIONS**  
1 East 54th Street New York 22, N. Y.



INDIAN COUNCIL OF WORLD AFFAIRS  
NEW DELHI  
FEBRUARY, 1954



THE INDIAN COUNCIL OF WORLD AFFAIRS is an unofficial and non-political body, founded in 1943 to encourage and facilitate the scientific study of Indian and International questions. The Council, as such, is precluded by its rules from expressing an opinion on any aspect of Indian or International Affairs. Any opinions expressed in this paper are, therefore, the opinions of the author and not those of the Council.



## THE COMMONWEALTH AND INDIA'S FOREIGN POLICY

The emergence of India, Pakistan and Ceylon as sovereign states and their decision to retain their membership of the Commonwealth are significant developments in its history. Although they did not change the character of the relationship between the Commonwealth members, they certainly changed its composition by bringing into it as self-governing partners the countries of another continent and peoples of a different colour and race whose history and traditions were different from those of others.

### INDIA'S REPUBLICAN STATUS AND ASSOCIATION WITH THE COMMONWEALTH

In April 1949 the Prime Ministers of the United Kingdom, Australia, New Zealand, South Africa, India, Pakistan and Ceylon and the Canadian Secretary of State for External Affairs met in London to exchange views upon the important constitutional issue arising from India's decision to adopt a Republican form of constitution and her desire to continue her membership of the Commonwealth. The effect of such a decision on the part of India upon the existing structure of the Commonwealth and on the constitutional relations between its members was discussed at length. The conference noted the "traditional capacity of the Commonwealth to strengthen its unity of purpose while adapting its organisation and procedures to changing circumstances". The final communiqué, issued after the conclusion of the Conference, on 27 April 1949 stated: "The Government of India have declared and affirmed India's desire to continue her full membership of the Commonwealth of Nations and her acceptance of the King as the symbol of the free association of its independent member nations and as such the Head of the Commonwealth. The Governments of other countries of the Commonwealth, the basis of whose membership of the Commonwealth is not hereby changed, accept and recognise India's continuing membership in accordance with the terms of this declaration".

120655 g ALA 22 pte  
The Indian Constituent Assembly's decision to give unilaterally to this country the status of a republic was a departure from the practice of other Commonwealth countries. In regard to the constitutions of most of these countries, although they were normally

drawn up by representative Assemblies of the countries concerned, they were in each case finally embodied in an act of the Parliament of the senior partner, the United Kingdom. But the constitution of the Republic of India came into effect on 26 January 1950 only in accordance with the decisions of the Indian Constituent Assembly. Another difference is that the titular Executive of India is not appointed by the Crown but elected by an electoral college in India. It can therefore be contended that both the constitution of India and the formal head of the Indian State have an "impeachable local source for its authority, in terms of both its historical and juridical origin".

However one has to guard against exaggerating the importance of these differences. One must not ignore the fact that the constitutions of other Members of the Commonwealth were also at first drawn up by the representative Assemblies of the countries concerned, and in some cases even submitted for popular approval at a referendum, and only then taken up by the United Kingdom Parliament. The Crown's power of appointment of the Governors-General has also been nominal because it is exercised only in strict compliance with the wishes of the Governments in power in the countries concerned. It is also to be noted that the Indian Constituent Assembly itself became a sovereign body only after the Indian Independence Act was passed by the British Parliament. It can also be argued that the same Sovereign can have both a local and an imperial root and the contradistinction between the Governor-General and the President is of no real significance at all.

Here a question may be asked: if these differences between the position of India and that of other countries are of no great significance, why were such formal changes made at all? To answer this question one must take note of the attitude of the Indian people towards the British Commonwealth before and after the achievement of India's independence.

#### PUBLIC OPINION AND THE COMMONWEALTH

There was no doubt that before 1947 a large section of the politically conscious people of India was hostile to the idea of India maintaining any connexion with the Commonwealth. Even in April 1949 when the Government decided to associate India with the Commonwealth many in the country vigorously



criticized this step. There were even cries of a "great blunder" and "an outrage on the national sentiments of the Indian people". It was maintained that this decision went against the pledges the leaders of the national movement had taken during India's struggle for freedom and the spirit of the Constituent Assembly's resolution declaring India a "sovereign democratic republic". It is also noteworthy that this initial opposition to India associating with the Commonwealth has not subsided and that, on the other hand, it has even gathered new strength in some quarters. Among the political parties of the country only the Congress is committed to maintaining the connexion with the Commonwealth. It is still the ruling party in the Centre and in other states and still enjoys the confidence of the bulk of the people. Among the other political forces the Hindu communalists, the Socialists and the Communists have at one time or other expressed their opposition to the Commonwealth. The parties representing these political forces, except the Communists, are not always very vigorous in expressing their views on this matter. However, it can safely be asserted that even now the connexion with the Commonwealth is not a non-controversial issue in India. This matter is important because the Governments of other Members of the Commonwealth do not face the problem to the same extent. In Ceylon and Pakistan there are some people who want their countries to break away from the Commonwealth; but the support they receive is not very considerable. South Africa's position is unique, because in that country it is within the ruling party itself that the question of breaking away from the Commonwealth is raised.

One of the apparent contradictions in the Indian political scene is that while on the one hand the opposition to India's association with the Commonwealth has not abated, on the other hand there is also an increasing support to the Government's foreign policy in general, although the former is only a significant aspect of the latter. A close examination of facts will, however, reveal that this contradiction is only apparent and not real. The reason why even those, who oppose India's link with the Commonwealth, are substantially in agreement with the basic approach of the Government of India towards world problems is that recent events have proved that this link has not hindered India in her pursuing an independent foreign policy.



While replying to the debate on India's association with the Commonwealth in the Indian Parliament, India's Prime Minister maintained that the Indian Government's decision was not against the past pledges of the nation's leaders and that the Government had not undertaken any new commitments in the international field. He asked the members whose attitude towards the United Kingdom was still clouded by India's struggle for freedom from that country to "look at things in a slightly different perspective". He added: "the world has changed; England has changed; India has changed; everything has changed and is changing..... From that point of view, Europe belongs to the past and the centre of world history, political and other activities shifts elsewhere. If you talk of British Imperialism and the rest of it, I would say that there is no capacity for imperialism even if the will was there; it cannot be done. The French are functioning imperialistically in parts of Asia. ....There may be strength behind it today; it may last even a few years and therefore, we have to be vigilant. I do not deny that—but let us not think as if Europe or England was the same as it was 15 or 20 years ago. It is not".

This explanation and the republican status have to some extent satisfied the popular sentiment in India.

#### THE UNITED NATIONS AND COLLECTIVE SECURITY

India has taken a particular view on the question of the United Nation's rule in the field of the maintenance of international peace and security—a view which was not always in consonance with that of some other Members of the Commonwealth and the United States. The frequent exercise of veto by the Soviet Union in the U.N. Security Council has very often paralysed the working of that body and has led to a revision of thinking on the part of some Western Powers on the structure and organisation of the United Nations. The view of a fairly influential section of the American people on this subject is summed up as follows :

"Although it is admitted that the veto has proved a serious obstacle to the building up of collective security, and that in the terms, and even the spirit, of the Charter as originally drawn up, there is no provision for effective security action in the event of Great Power disagreement, the conclusion drawn is that the purposes for which the organisation



was founded cannot be allowed to be frustrated. Other means to the same end must be worked out, despite a possible risk of Soviet withdrawal from the organisation. In the American view the Soviet Union not only bears the responsibility for obstructing the security functions of the United Nations, it is itself the supreme menace that confronts the free world today. Hence the United Nations, if it is worth anything, should throw its potentialities for action into the scales".\*

Very often the action of the United States in the U.N. bodies has followed from this attitude. It is doubtful whether any Member of the Commonwealth would go so far as this in holding these views. But what is more important is their actions in the international conferences and it seems that some Members of the Commonwealth, though not holding this American view, have gone very far with the United States while casting their votes in the U.N. bodies on issues of this nature.

The same report, from which the extract about American view on the U. N. is given above, referring to the British view says: "The prevailing opinion in Britain concerning security runs as follows. The basic premise of the United Nations is co-operation between the powers, especially the Great Powers that were united in war against Germany and Japan. Its mandate for effective action derives from this co-operation. The veto power written into the Charter was an explicit recognition of the fact that the issue of peace and war could be handled by the organisation only when there was a Great Power unanimity. In the present situation that unanimity is lacking. Hence "collective security" in the sense of forceful action against an aggressor within the framework of the United Nations, is only a limited possibility, and the organisation should concern itself primarily with its other functions—conciliation, negotiation and mediation." To an Indian this looks like a summary of the Indian view on the U.N. as well.

But the difference arises at the time of voting on some of the American proposals in the U.N. General Assembly. In 1947 the United Kingdom supported the U.S. proposal to set up an Interim Committee of the General Assembly to consider matters impairing

---

\* *Britain and the United States* (New York, Harper & Brothers, 1953), p. 65.



friendly relations between states and to recommend the calling of a special session of the Assembly when necessary. When the Committee was established, the Soviet Union boycotted it on the ground that it was an attempt to by-pass the Security Council. India, which had earlier agreed with the proposal to constitute the Committee, later suggested that it should be discontinued because without the participation of the Communist states it was sure to be ineffective. But not so the other Commonwealth countries. The attitude of different Members towards the "Uniting for Peace" resolution accepted by the General Assembly in 1950 was also significant. There were some provisions in this resolution on which India abstained. These provisions, which were finally accepted by the Assembly, asked all member states to earmark in their armed forces special elements which could be made available for United Nations service when called upon either by the Security Council or by the General Assembly and set up a Collective Measures Committee to study and report on these and other methods for maintaining and strengthening international peace and security. Although British public opinion has viewed these and other American efforts to change the character of the U. N. with certain misgivings noted above, the British Government has publicly supported them. The United Kingdom was even one of the sponsors of this resolution and other Commonwealth countries also supported it.

In other Commonwealth countries, except in India, there was not even the expression of a widespread fear that any attempt against the determined opposition of a major power to transform the United Nations into an enforcement agency could in the present circumstances only result in its disruption. In India public opinion more or less supported the India Government's view that it was the time to concentrate on improving the machinery of the U.N. for the tasks of peace and not those of war.

Even the spokesmen of the British Government were not found wanting in expressing some misgiving about the new course the U. N. was taking in regard to some matters. In a speech at New York in 1952 Sir Gladwyn Jebb, Britain's permanent delegate to the U. N., warned his hearers that were the Soviet Union to be driven out of the United Nations, some of the Arab and Asian countries might leave it. The British diplomat was suggesting that



these states would do so not because they wished to throw in their lot with the Soviet bloc, but rather they would seek to avoid membership of an organisation which might involve them, perhaps automatically, in a struggle between the Great Powers. There is no doubt that when Jebb said this he was having the Asian Members of Commonwealth, and especially India, in his mind. Other prominent Britishers have also stated before American audiences that the United Kingdom would not be in a position to go very far with the United States in some matters without breaking the solidarity of the Commonwealth.

#### COMMUNIST CHINA AND THE WORLD COMMUNITY

India, Pakistan and the United Kingdom recognized the new Government of China in 1950. In September 1950 the Indian delegate told the General Assembly that he would introduce a draft resolution under which the Peking regime would be identified as the representative of China in the U.N. Explaining India's stand on this issue, the delegate stated that the obligations of the U.N. membership could be carried out only by a government "with a reasonable expectancy of permanence, actually exercises control over the territory of that Member and commands the obedience of its people", and, he added, the Peking regime was "the only such Government functioning in the Republic of China as now constituted". India also exchanged diplomatic representatives with the new regime.

Great Britain also took a similar view and recognized the new regime as early as January 1950. The British Government stated that this was "an acknowledgment of fact, not a mark of approbation". Although this action was mainly determined by the British interests it is noteworthy that it has also been contended that "the timing of this British action was also, as we have seen, influenced by the views of India, which favoured prompt recognition."\*

Pakistan, though not as vigorously as India, supported the new Government's claim to be represented in the U.N.

In 1950 Canada abstained on the Indian resolution supporting Communist China's claim to be represented in the U.N. It was very difficult to know to what extent that decision was an attempt to accommodate the wishes of India, Pakistan and Britain. Australia,

---

\* *Britain and the United States*, op. cit. p. 228.



New Zealand and South Africa, then and later, opposed the new regime's claim to be represented in the U.N.

India never wavered from the position of championing the right of Communist China to take the seat in the U.N. even when the Korean war and China's intervention later in it clouded the issue. In January 1951 the United States moved a resolution in the U.N. General Assembly branding Communist China as an aggressor. India opposed this resolution and along with the Communist States and Burma voted against it in the plenary session. Among other Commonwealth Members Pakistan abstained and others voted for the resolution. However, there was a large number of people in Great Britain who were inclined to believe that China's intervention might well have been a defensive measure.

#### THE KOREAN WAR

In regard to the U.N. action in Korea there was not much difference of opinion between the Members of the Commonwealth as far as the principle behind the U.N. action was concerned. India, which was a member of the Security Council during 1950, accepted the Council's resolutions. But on the ground that her armed forces were adequate only for the defence of the country, she did not send any armed forces to participate in the U.N. action. However she sent an ambulance unit to associate herself symbolically with others who were involved in the war. Pakistan also has not sent troops.

When the United Nations' forces reached the narrow waste of Korea in the autumn of 1950 there were some divergences of opinion between those U.N. members who had their forces there. Most of the Commonwealth Members were not enthusiastic about taking any steps which would increase the international tension and enlarge the area of armed conflict. The efforts of the Arab Asian Group to bring about a peaceful settlement by negotiation were supported by them. In December 1950 the U.N. General Assembly constituted a three-man Group, charged with consulting the two High Commands or their representatives and reporting to the Assembly on the most suitable basis for a cease-fire. The members of the Committee were Assembly President Entezam, Sir B.N. Rau of India and Canadian External Affairs Minister Lester B. Pearson. Although the work of this Group did not yield any substantial results, it did indicate the desire of many Members to come to a settlement with the Chinese and the North Koreans.



When India moved its resolution on the prisoners of war in the 1952 session of the U.N. Assembly, it seemed to the American delegation that the Indian proposals fell considerably short of guaranteeing fair treatment to those prisoners who did not wish to be repatriated. But the British Foreign Secretary Eden told the Political Committee that the Indian proposal was "timely and constructive" and agreed with the Indian delegate's view that it would be a mistake "to examine too legalistically every word and every phrase". Eden made it clear that Great Britain would support the plan with some amendments. Canada, another Commonwealth Member, also leaned towards Britain's position. The Indian proposals were worked after exhaustive consultation with Arab-Asian delegations also. Even when India's efforts failed again—at least temporarily—to solve the problem of the prisoners of war, the Members of the Arab-Asian Group—including Pakistan and India—abstained from a Soviet resolution on America's activities in Korea and thus tried to maintain their role as mediators.

#### RACIAL DISCRIMINATION

The questions connected with the racial discrimination and colonial domination were sources of disagreement, and even discord, among the Commonwealth Members. As early as May 16, 1949 Pandit Nehru told the Constituent Assembly of India: "I am asked often, how can you join a Commonwealth in which there is racial discrimination, in which there are other things happening to which we object. That, I think, is a fair question and it is a matter which necessarily must cause us some trouble in our thinking. . . . One of the pillars of our foreign policy, repeatedly stated, is to fight against racial discrimination, is to fight for the freedom of suppressed nationalities. Are you compromising on that issue by remaining in the Commonwealth? We have been fighting on the South African-Indian issue and on other issues even though we have been thus far been a Dominion of the Commonwealth. It was a dangerous thing for us to bring that matter within the purview of the Commonwealth. Because then the very thing to which you and I object might have taken place. That is, the Commonwealth might have been considered as some kind of a superior body which sometimes acts as a tribunal, or judges, or in a sense supervises the activities of its member nations. That certainly would mean a diminution in our independence and sovereignty, if we have once accepted that principle



Therefore, we were not prepared and we are not prepared to treat the Commonwealth as such or even to bring disputes between nations of the Commonwealth before the Commonwealth body. We may, of course, in a friendly way discuss the matter; that is a different matter". Even those who do not object to India's link with the Commonwealth agree with this view expressed by India's Prime Minister. At the same time one has to note the fact that some of these questions do affect the relations between the Members of the Commonwealth and indirectly the concept of the Commonwealth association itself.

When the question of the treatment of the people of Indian origin in the Union of South Africa was tackled by the U.N. General Assembly, among the Commonwealth Members, only South Africa voted against the mildly worded resolutions of the Assembly. But no other Member was prepared to go as far as India and Pakistan on this issue. In 1949 the United Kingdom abstained on the Franco-Mexican resolution inviting the parties concerned to enter into discussions at a round-table conference. Denying that there was any dispute between India and South Africa, the Union Government's representative voted against the resolution; Australia, Canada, India, New Zealand and Pakistan voted in favour.

When a comparatively strongly worded resolution was adopted by the 1950 session of the U.N. Assembly India and Pakistan received less support from the other Commonwealth Members. This resolution expressed the view that the policy of racial segregation (Apartheid) was necessarily based on the doctrine of racial discrimination and called upon South Africa to refrain from implementing the Group Areas Act. The representatives of Australia and South Africa questioned the competence of the Assembly to pass such a resolution. The United Kingdom and Canada did not express any view on the question of the competence of the Assembly.

In 1951 the Assembly by a resolution constituted a Commission for the purpose of assisting the parties in carrying through appropriate negotiations and again called upon South Africa to suspend the implementation of the Group Areas Act. The Union of South Africa absented from the Assembly when it was voting on this resolution which was supported by India and Pakistan; other Commonwealth Members abstained on this resolution. The same

trend continued later also. In 1952 when the Indian representative called on the Assembly to make a new attempt to seek an amicable settlement of the problem, no support was forthcoming from the Commonwealth Members, except Pakistan. They, with the exception of South Africa, abstained on the resolution on this matter.

Apart from the treatment of the people of Indian origin, the general question of race conflict in Africa was taken up by the Assembly in 1952 and a resolution was adopted on the subject. On the operative paragraph of this resolution, which suggested the establishment of a Commission to study the problem, India and Pakistan voted in favour, Australia, New Zealand, United Kingdom and South Africa voted against and Canada abstained.

#### INTERNATIONAL RESPONSIBILITY FOR DEPENDENT AREAS

The role of the United Nations in the field of the Dependent Peoples was a matter on which there was no agreement between the Asian Members of the Commonwealth and others.

India was opposed to the decision of the Union of South Africa to incorporate South West Africa into its territory. Only the United Kingdom wholeheartedly supported the Union Government's action.

Towards the U.N. Trusteeship Territories India's approach was based on the following considerations: (1) The United Nations must have the ultimate power to supervise the administration of the Trust Territories, and the Administering Powers should act only as agents of the U.N. (2) Early steps should be taken to grant complete self-government to the people of the Territories. (3) Racial Discrimination in any form should not be practised in the Trust Territories.

India placed before the General Assembly many proposals based on these principles. Most of them were vigorously opposed by Great Britain, Australia and New Zealand—and were not supported by Canada and the Union of South Africa. They thought that they would lead to an unwarranted interference in the administration of the territory by the U.N.

Differences of opinion among the Commonwealth Members on the matter of international responsibility for colonies were still more sharp than that on the Trust Territories. There was no



agreement on what was meant by the term, "Non-self-governing Territory" nor on the question who would determine when a particular territory would cease to be non-selfgoverning. The nature of the information which the Colonial Members should send to the U.N. in regard to their colonies and the use to which it must be put were also matters on which there were differences of opinion. India and Pakistan felt that only the U.N. should determine the status of the territory while other Members were of the opinion that each Administering Power could decide that. They were not prepared to send information of a political nature to the U.N. ; nor did they support the establishment of a subsidiary organ like the Special Committee on non-selfgoverning territories to examine the information received by the U.N. in regard to the non-self-governing territories. Very often the Administering Powers, including the Commonwealth Members in it, charged the U.N. Special Committee on colonies, and especially the Arab-Asian Members of it, with trying to interfere in their domestic matters. There were very often heated debates on this issue in the U.N.

A more violent controversy was created by the Indian Prime Minister's recent comments on the developments in Britain's territories in Africa. Some responsible journals and persons in Great Britain stated that Nehru's comments were unfortunate from the standpoint of Commonwealth solidarity. Others, less responsible, even agreed with Prime Minister Malan's view that India was trying to dominate Africa and was considering the white colonialists there as a hindrance to its imperialist ambitions.

In this connection it is interesting to note that prominent Indian Communists had accused Pandit Nehru for not taking a strong stand against Britain's rule in Malaya, in Africa and Guiana. They accused the Indian Prime Minister of allowing the Gurkhas of Nepal, who were recruited to the British Army, to pass through India and help the British police action in Malaya and elsewhere.

#### COMMONWEALTH AND DEFENCE

It is very often asserted that Britain is committed to the defence of the Commonwealth and most communiques issued after the Commonwealth Prime Ministers' Conferences have stated that defence was one of the subjects discussed by them. But so far no Commonwealth defence policy as such appears to have been worked

out. While defending India's association with the Commonwealth, Prime Minister Nehru has often stated that India would neither accept a role in Commonwealth defence as such nor sacrifice her independent foreign policy. Among other Commonwealth countries also there was not much enthusiasm to conclude a Commonwealth defence agreement. Some among them were now looking for defence agreements and military alliances with states other than the Members of the Commonwealth.

One of the new developments in the field was the ANZUS, the defensive agreement signed on September 1, 1951 by the United States, New Zealand and Australia. It was pretty clear that Great Britain wished to be associated with the pact. But she could not become a formal signatory to a Pacific Pact unless it would cover Malaya, Singapore and Hong Kong. Little official information is available on the question of British participation in the ANZUS. But many press reports indicate that Britain was not very happy with the manner in which the pact was concluded.

The negotiations between the U. S. and Pakistan on the question of American military aid to the latter also suggest that the ultimate effect of some aspects of America's diplomacy is to promote the security of the individual Members of the Commonwealth, perhaps at the expense of the Commonwealth unity in this field. There is no doubt that so far, like India, Pakistan was to a great extent depending upon Great Britain for military equipment and stores. Recent developments show that she may gradually depart from this practice and will be integrated with America's schemes for maintaining security in this region.

India is still depending upon the Commonwealth countries and especially on the United Kingdom for much of her military equipment. For specialised training Indian army personnel are still being sent to the United Kingdom. In regard to the work of the staff colleges there are reciprocal arrangements between India and other Commonwealth countries.

India's approach towards the question of making arrangements for the defence of the country is primarily determined by her basic approach towards world problems which is one of maintaining friendly relations with all nations. She is not engaged in preparing for a war, but in reducing the tension in the international field which would lead to a war.



## CONCLUSION

While defending India's link with the Commonwealth, India's Prime Minister said: "It is in the belief that India could more effectively pursue the policy of encouraging peace and freedom and of lessening the bitter hatreds and tensions in the world, that I willingly agreed to the London Agreement". How far has this view been justified? It is very difficult to show how one Member of the Commonwealth is influencing other Members because most of the consultations and exchanges of views between the Commonwealth Members are conducted in an informal and confidential manner. The communiques issued after the Prime Ministers' Conferences refer to the issues discussed and conclusions reached only in very general terms. Moreover the Commonwealth members were not always agreed on the approach towards some of the vital problems in the international field. The concept of the Commonwealth association does not envisage any unity of the foreign policies pursued by different States. Very often they can only agree to differ.

The attitude towards the "Cold war" is one issue on which they agree to differ. There is no doubt that the maintenance of international peace is one of the aims of all Commonwealth countries in the international field. But very often there have been fundamental differences of opinion between the Commonwealth countries on the question of the choice of means to achieve this aim. The historical circumstances, the geographical situation and the economic needs of each country have influenced it to look upon each important international issue in its own way. For instance, Britain, Australia and New Zealand have found it necessary to conclude military pacts with the United States for their own security. Pakistan to-day is also going in the direction of military co-operation, if not alliance, with the United States. In the field of security Ceylon also is closely connected with the Western Powers as the result of her military alliance with the United Kingdom.

India has not participated in any regional military agreement nor has she shown any inclination for concluding any military agreement with any of the Big Powers.

The Government of India has had to concentrate on economic development and would it find difficult to participate in any programme of rearmament. Moreover, India's leaders believe that the



military pacts and vast rearmament programmes will increase the chances of war rather than give security to the States launching them.

Although this difference of approach between India and other Members of the Commonwealth is important, it is to be noted that on many specific international issues concerning peace and war, India and other Members of the Commonwealth have found areas of agreement between them. We have already noted how in regard to Indian proposals to ease the tension in the Far East the majority of the Members of the Commonwealth have acted together. In her peace efforts India finds its hands strengthened by the influence exerted by other Commonwealth countries, especially the United Kingdom. This was evident when the question of the representation of China came up before the U.N.: the Indian resolution on the Korean prisoners of war was being discussed in the Assembly and the opposition to the proposal to use Atom Bombs in Korea, was expressed in different Commonwealth countries.

Other important matters on which India and some other Members of the Commonwealth disagreed are connected with the dependent peoples of the world. Britain's declared policy is to grant self-government to her colonies when they are in a position to govern themselves. The Indian Government itself realises that all dependent peoples are not now in a position to achieve immediately the status of self-governing status. On this matter the difference of opinion is mainly concerned with international responsibility for dependent areas.

The question of race relations in different Member-countries of the Commonwealth is, as we noted, another source of discord among the Commonwealth countries. In regard to this matter, India and Pakistan were giving emphasis to the moral and political issues involved while other Members were stressing the legal aspect of the matter.









UNIVERSITY PRESS  
UNIVERSITY BUILDINGS  
DELHI 8

57  
178  
V.2

Oak Street  
UNCLASSIFIED

# INDIA AND THE COMMONWEALTH

## PART II ECONOMIC



BY  
DR. B. N. GANGULI

PREPARED FOR THE  
COMMONWEALTH RELATIONS CONFERENCE  
1954  
LAHORE

Distributed in the United States by  
INSTITUTE OF PACIFIC RELATIONS  
1 East 54th Street New York 22, N. Y.



INDIAN COUNCIL OF WORLD AFFAIRS  
NEW DELHI  
FEBRUARY, 1954



THE INDIAN COUNCIL OF WORLD AFFAIRS is an unofficial and non-political body, founded in 1943 to encourage and facilitate the scientific study of Indian and International questions. The Council, as such, is precluded by its rules from expressing an opinion on any aspect of Indian or International Affairs. Any opinions expressed in this paper are, therefore, the opinions of the author and not those of the Council.

## INDIA AND THE COMMONWEALTH

### TREND OF IMPORTS AND EXPORTS

India's trade relations with the Commonwealth after the second world war have been dominated by the new trends which have developed in consequence of the structural changes in India's economy after Partition and by the requirements of planned economic development and of adjustment to structural changes.

A brief review of these new trends of trade is necessary in order to set the significance of India's trade relations with the Commonwealth in proper perspective.

As regards India's imports, the Commonwealth and the Empire which had declined in relative importance as a source of imports during the second world war gradually recovered its position in the post-war years. In 1949-50 it did not, however, attain its prewar importance in spite of the emergence of Pakistan as a separate trading unit within the Commonwealth. An important feature of India's import trade with the Commonwealth and the British Empire was the relative decline in the importance of the U.K. and the relative rise in the importance of Australia, Canada and Kenya, as sources of supply of India's imports. This was mainly due to India's increasing dependence on imports of food and raw materials. The rest of the world, excluding countries of the Commonwealth and the British Empire, also became relatively important as sources of supply of India's imports in the postwar period.

The most notable increase in the share of any individual country in India's import trade was in the case of the U.S.A. The U.S.A's share which was only 7 per cent in 1937-38 rose to 30 per cent in 1947-48. It declined to 17.7 per cent in 1948-49, with the recovery of the export capacity of other countries and mainly as the result of quantitative restrictions on dollar goods necessitated by the acute dollar crisis. In 1949-50 this percentage was still 15.7. The U.S.A. has become an increasingly important supplier of capital goods, important industrial raw materials like cotton, foodgrains, and essential consumer goods.



Next to the U.S.A. the other important countries which have gained in importance as sources of supply of imports are Iran (oil), Egypt (raw cotton), Italy (textiles and various other consumer goods), and Switzerland (high-grade precision instruments).

Another important postwar trend has been the resumption and gradual expansion of India's imports (rice, timber, mineral oils, etc) from countries of Southeast Asia, which merely underlines India's dependence on imports of food and essential raw materials.

In general, the post-war trends of India's imports have been influenced by (a) the necessity of importing larger quantities of capital goods, food and raw materials and (b) redirection of trade as determined by payments considerations, especially the necessity of economizing expenditure of hard currencies.

Fortunately, by 1949-50 the soft currency area had recovered from the paralyzing effects of the war and actually increased its share in India's imports compared with prewar. The share of the sterling area declined, while that of the non-sterling soft currency area rose considerably. This was due not only to the changing commodity composition of India's import trade, but also to the successful search for non-dollar sources of supply through the conclusion of numerous bilateral trade agreements. One may mention in this connection the increasing share of West Germany and Japan in India's import trade and the steep decline in that of the U.S.A.

As regards India's export trade, this has also been vitally affected in the post-Independence period by the economic consequences of Partition and the fall, moderate or steep as the case may be, of internal supplies of raw jute, raw cotton, hides and skins, raw wool and tea in the early post-war years. Before the war nearly 40 per cent of exports was accounted for by the "enemy" or "enemy-occupied" countries which absorbed nearly 75 per cent of India's exports of raw cotton, between 60-70 per cent of the exports of iron and steel, metallic ores and coal and nearly 50 per cent of the exports of oilseeds, raw jute, cotton manufactures, tobacco and vegetable oils, and which were also important markets for India's raw hides and skins, lac, manganese, mica, oil cakes and spices. The disappearance of these export markets brought difficult problems of diversion or absorption of this exportable surplus during and immediately after

the war. After Partition there had to be a change in the commodity composition of India's export trade and its destination pattern. Exports had also to be diversified as far as possible. The search for non-dollar sources of supply of imports led to India entering into bilateral trade agreements with a number of soft currency countries, and this, in turn, brought about a certain degree of diversification of India's exports. More than 100 export items figured in these agreements, and most of them were outside the narrow range of India's staple exports. Thus the distribution of India's export trade between the "soft currency countries" and the "rest of the world" practically conformed to the prewar pattern. But within these two groups of countries there were significant changes in the relative importance of countries. Thus within the soft currency area the share of the U.K. declined, while the shares of Australia, East Africa, Southeast Asia and countries of the Near and Middle East increased. Within the hard currency area the share of the U.S.A. declined considerably after 1947, while that of Japan and West Germany registered a substantial increase, (the rise in exports was commensurate with the rise in imports by virtue of the operation of trade agreements).

Roughly till the outbreak of the Korean war the following trends of trade seemed to be significant :—

(1) Out of the 7 important export staples the four which are important were very largely absorbed by the sterling area. The sterling area had declined in importance, compared with prewar, as a source of supply of India's imports. Nevertheless, in 1949-50 it accounted for about 46.1 per cent of the total value of India's imports.

(2) The expansion of India's trade with non-sterling soft currency countries was a remarkable development.

(3) There was expansion of trade with non-dollar, hard currency countries like West Germany, Japan and Argentina.

(4) The trade with medium currency countries of Western Europe (Switzerland and Sweden) was hampered by payments difficulties.

(5) The most remarkable trend was the expansion of India's foreign trade with the soft currency countries of southeast Asia, East Africa and Near and Middle East which supplied India with food



and basic raw materials in exchange for manufactured goods, exports of which were conducive to the diversification of India's exports.

The organization and successful functioning of the European Payments Union in 1950 removed the "payments" problem and cleared the way to the expansion of trade between India and countries of Western Europe previously characterized as hard and medium currency countries. During the second half of 1950 the sterling area was running with its partners in E.P.U. a surplus increasing at the rate of \$300 million a year. The sterling area's strong creditor position made it easier for India to take advantage of a Wider European market outside the U.K. for both exports and imports without the constraints of economy of hard and medium currencies. Thus India's trade with West Germany, Sweden, and "Benelux" countries was bound to expand. This development, however, had a fortuitous element in so far as it was due to the overwhelming demand for basic raw materials (many of them being 'strategic' in character) which was stimulated by the economic recovery of Western Europe and the rearmament boom. But the existence of a stable payments mechanism in Western Europe linked with the sterling area was an important stabilizing factor in India's foreign trade as a whole and its trade with the sterling area. It was possible for India to take full advantage of the payments facilities by offsetting the possible deficit on trade with countries of the Western European Union by the current surplus on trade with the sterling area and/or by current releases of sterling balances. That this trend has continued in 1950-51, 1951-52 and 1952-53 is confirmed by the statistics given in the following table. This table also illustrates India's stake in the sterling area in relation to the E.P.U. and the dollar area.

PERCENTAGE SHARES IN INDIA'S EXPORTS AND IMPORTS AND  
BALANCE OF TRADE

	1950-51			1951-52			1952-53		
	Percentage shares		Balance of Trade (In Rs. millions)	Percentage shares		Balance of Trade (In Rs. millions)	Percentage shares		Balance of Trade (In Rs. millions)
	Exports	Imports		Exports	Imports		Exports	Imports	
Common-wealth	53	47	+213	53	39	+262	49	41	+55
Sterling Area	56	47.6	+373	55.5	39.7	+312	51	41	+204
Dollar Area	23	22	-39	23	32	-1403	24	32	-742
OEEC countries	9	11	-154	7	11	-493	10	12	-268

It is apparent that during the last three years the sterling area in general, and the Commonwealth in particular, have accounted for almost 50 p. c. of the total value of India's exports. The share of the Commonwealth in India's total imports declined from 47 p.c. in 1950-51 to 39 p.c. in 1951-52 after the collapse of the post-Korean boom. During the recovery of 1952-53 the percentage increased by 2 p.c. to 41 p.c. It seems that while the Commonwealth has maintained its relative importance as a purchaser of India's exports, India's imports of food, basic raw materials and capital goods, as determined by its developmental needs, have tended to be derived increasingly from the dollar area and OEEC countries. It will be noticed that India's passive balance of trade in relation to the dollar area and OEEC countries has been consistently offset to an appreciable extent by the surplus of current earnings of sterling. While the advantage of India's membership of the sterling area is obvious, it is clear that India has an important stake in the eventual free interconvertibility of sterling, European currencies and the dollar. In interpreting the figures given above one must note that the large passive balances in relation to the dollar area in 1951-52 and 1952-53 are explained mainly by the U.S. wheat loan amounting Rs. 380 million in 1951 and Rs. 526 million in 1952. The burden of adjustment thrown on the Commonwealth and the sterling area has been, therefore, minimised. In fact the actual use of monetary reserves by India during these years has been less than the agreed releases of sterling.

#### BALANCE OF PAYMENTS PROBLEM

The main elements of India's balance of payments problem are clearly indicated by the trends of trade noted above. The general balance of payments situation has improved significantly since 1949. In spite of fluctuations in response to the phases of the post-Korean boom and the subsequent downturn the basic position has visibly improved. The data quoted in the recent report of the International Monetary Fund Mission to the Government of India make this abundantly clear. Taking into account goods, services, private donations, private capital movements, contractual official payments and the resources for development provided by the World Bank, the



Colombo Plan and the U.S. Mutual Security Administration grants, the trend of balance of payments has been as follows :—

<i>Year</i>	<i>Surplus + Deficit -- (In Rs. million)</i>
1948	— 1126
1949	— 1586
1950	+ 265
1951	— 694
1952	— 702

The deficits which appeared in 1951 and 1952 have been small in magnitude and, as the report mentioned above puts it, “the deficit is not in excess of the reduction of reserves that the Government of India is willing to have”. In 1950, 1951 and 1952 monetary reserves were drawn down to the extent of only Rs. 1 billion, and this was not excessive for a country which had accumulated enormous sterling balances in wartime and could use them for purposes of economic development. The actual use of monetary reserves, as already said, has been less than the agreed releases of sterling owing to the U.S. wheat loan amounting Rs. 380 million in 1951 and Rs. 526 million in 1952, which accounted for about one-half of the combined deficit of Rs. 1.8 billion with the hard currency areas in 1951 and 1952. Excluding the wheat loan transaction, the remainder of the hard currency deficit (on current account) was not more than in 1948 and 1949 in terms of rupees and about 30 p.c. less in terms of dollars. During the first half of 1953 the payments position in relation to dollars improved considerably and India contributed to the dollar reserves of the Commonwealth and the sterling area. This is not to say, however, that the Commonwealth as a whole and an individual member of the Commonwealth like India can afford to be complacent about the balance of payments situation. We shall return to this aspect of the question when we discuss below some of the pressing economic problems facing the Commonwealth in relation to the urgency of fulfilling India’s first Five Year Plan of economic development during the remaining three years of the five-year period.

#### INDIA AND COLLECTIVE COMMONWEALTH APPROACH TO ECONOMIC PROBLEMS

In this section it is proposed to discuss India’s attitude to what may be called the collective Commonwealth approach to problems of economic expansion, trade and balance of payments.

From the economic point of view the Commonwealth has been bedevilled by the worldwide dollar problem after the second world war. In 1947 before the Marshall Plan came into operation the world dollar deficit had reached a peak of \$ 11 billion which was reduced by one-half during the first two years of the Marshall Plan. The Korean War which led to heavy buying by the U.S.A. of raw materials and other goods and services overseas reduced the dollar deficit to a little more than \$ 1 billion in 1950. With the collapse of the post-Korean boom there was a violent swing of the pendulum in the direction of mounting dollar deficits. During the last two years there has been a swing in the opposite direction. For the first time after the war the U.S. foreign trade, *exclusive of military exports*, has reached a balance. Thus in 1952-53 the whole of the U.S. overseas private and governmental investment and the whole of U.S. economic aid went to swell the gold and dollar reserves of the rest of the world which have been increasing at a current rate of \$ 2½ billion per year. The monetary reserves of the sterling area have increased by \$ 700 million. It would be illusory to imagine that the dollar problem of the Commonwealth is near solution. If we take into account extraordinary dollar expenditure (disbursements by U.S. military and civilian establishments abroad, offshore procurement and stockpiling) running at an annual rate of \$ 3 billion and economic aid running at an annual rate of \$ 2 billion, there is a concealed dollar gap of \$ 2-3 billion per year. This gap will increase, if there is a recession in the U.S.A., if there is a cut back in U.S. economic aid or if the favourable turn in the terms of trade of industrial countries is reversed. The present high level of U.S. imports is closely linked with the high level of U.S. gross national product. Between 1950 and the first half of 1953 the volume of industrial production in the U.S.A. rose by 21 per cent and the volume of U.S. imports by 14 per cent. It is difficult to assess the reaction of 5 per cent reduction in gross national product, which many knowledgeable persons have been anticipating, on U.S. imports and on the extraordinary overseas dollar expenditure of the U.S.A. At any rate, while it would be wrong to overestimate the impact of the American "recession" on "readjustment from an abnormally high level of economic activity", it would be clearly unrealistic to underestimate the danger ahead.

No doubt there has to be a marked diminution in the current outflow of gold and dollars (at the rate of over \$ 2 billion a year)



before there will be serious pressure on the reserves of the sterling area. But there is also no doubt that the sterling area will bear the impact of the depression more quickly and more severely than countries of Europe. The violent fluctuations of the sterling area reserves in recent years (a decrease of £ 780 million in 1951-52 followed by an increase of £ 240 million in 1952-53) and the equally violent fluctuations in its balance of payments (a deficit of £ 1000 million in 1951-52 followed by a surplus of £ 430 million in 1952-53 mainly as the result of drastic measures) clearly indicate that the safe margin required to ensure the liquidity of the sterling area is much larger than one would like to assess on the basis of the prewar standards determining the proper size of monetary reserves.

There is, therefore, need for collective approach based on the self-help of the commonwealth as a whole—an approach which developed in the context of a serious dollar crisis in 1951. The main elements of this approach are (1) pursuit of sound internal policies in every member country; (2) building up of central reserves; (3) maintaining a surplus with the non-sterling world; and (4) investment in projects which would serve common ends. These measures were designed to meet a situation which was dominated by economic weakness and inflationary pressures. Since then inflation has been curbed in many countries of the Commonwealth, productivity has increased and the competitive power of Commonwealth producers has become stronger. The process of reconstruction and development has been well under way. The four-fold plan mentioned above has, therefore, to be interpreted in the light of the necessity of continuing the expansionist process rather than stressing the restrictionist bias in our external and internal policies. Amongst sound internal policies one would stress curbing of inflation. Development on the basis of inflation is high-cost development, and since it tends to divert resources from the production for export to production for domestic consumption and stimulates excessive imports (unless they are controlled by import restrictions) it creates a serious balance of payments problem and thus imposes a strain on the central reserves of the sterling area. But a certain degree of inflation is inherent in rapid economic development provided it proceeds on the basis of an initially sound position of the economy and provided appropriate fiscal and monetary measures are adopted to utilise the stimulus without exposing the economy to the danger of an inflationary spiral. This is a difficult choice,

but in underdeveloped countries of the Commonwealth the alternative would be stagnation and grave political peril. If by investment in projects which would serve common ends is meant investment in projects which increase merely export capacity then such a policy would rule out a good deal by development in many countries the economies of which are not mainly export-oriented. Surely this is not meant by those who have evolved the policy of collective approach. Nevertheless, the necessity of export promotion is quite clear, because otherwise the objectives of (1) building up the reserves of the sterling area and (2) creating a current account surplus with the non-sterling world cannot be attained. But an important aspect of the question is broadbased economic development in the Commonwealth which would reduce the extent of dependence on dollar imports.

In any case in the context of the threatened recession in the U.S.A. the collective approach must be based not on restrictive, but on expansionist trade policy and expansionist internal economic policies. What are the implications of such a policy from the point of view of the Commonwealth's economic development, trade and balance of payments ?

It is necessary for members of the Commonwealth in the position of India to ensure investment and development. The mechanism that was contemplated in the Colombo Plan, with its provision for irrigation of southeast Asia with dollars as well as sterling, did at least aim at preventing the strain from this area from being sufficiently heavy in the next 6 years to bring the sterling area arrangements back to near collapse. The same policy should continue. There should be no drastic cut back in development programmes. If this policy is followed in unison the competitive power of the Commonwealth will be strengthened. A reasonably high level of activity and employment will stimulate the trade of the Commonwealth. Since it would be clearly necessary to reach equilibrium at a high level of exports and imports, increasing restrictions on imports have to be avoided even if it means running down of sterling area reserves to a certain extent. Some countries of the Commonwealth including India will not be able to sustain a reasonably high level of economic activity and development without external financial assistance. It is more than ever desirable at



this time that such assistance is made available within the sterling area as well as from outside it.

An expansionist policy in the field of production has implications as regards imports and balance of payments, which may be briefly discussed in the context of the Indian situation. Since July, 1952 India has added to its external reserves due largely to the drastic reduction of imports. Until recently India's principal exports—jute, tea and cotton—faced a shrinking market. The situation has recently improved a great deal. Any recession, unless it is short in duration and moderate in intensity, is bound to hit India's export trade. On the other hand, the existing low level of imports cannot be maintained for several reasons. First, destocking of commodities in 1952-53 is bound to be followed by the restocking movement in 1953-54. Second, increase of imports is inherent in the completion of the next stage of the Five Year Plan. Third, the rising trend of prices (not at all inflationary in the usual sense) will become more pronounced as development goes on (unless a sharp recession abroad counteracts the trend), and this will stimulate imports. Fourth, if the policy of raising import duties is adopted, for the two-fold purpose of gradually doing away with import quotas and raising the yield of customs duties as a source of development finance, one should expect an increase in the total value of imports. A probable increase of imports without any countervailing rise of exports is a problem which would be common to the entire Commonwealth. The Commonwealth, no doubt, has to try to have a substantial surplus with the rest of the world and at least a balance with the dollar area. But a restrictive policy as regards imports may not only hamper economic development according to plan, but also hamper the trade within the Commonwealth and may mean adjustment to a lower level of exports and imports in the case of members of the Commonwealth and accentuation of the recession if and when it comes. In the particular case of India husbanding of reserves which has been going on since 1952 will no longer be justified when we bear in mind the exigencies of the Five Year Plan.

The long-term expansionist policy which the Commonwealth has set before itself and which, as we have argued, must not be abandoned if and when a recession comes, rules out the expedient

of new preferential tariff arrangements to buttress intra-Commonwealth trade. Since 1949 quantitative restrictions on dollar imports for balance of payments reasons have afforded Commonwealth products cent per cent preference in many cases. In the face of this the issue of tariff preference has paled into insignificance. If it is the long-term objective of the Commonwealth to relax quantitative restrictions and seek a wider multilateral system of payments, new Commonwealth preference (in addition to the existing preferential tariff rates which have their use for bargaining purposes) will clearly be against the spirit of the long-term objective and would run counter to economic opinion in India.

It may be asked whether the expansionist policy accepted by the Commonwealth so far should mean pursuit of sterling convertibility even in the face of a recession? The fact that the spot pound-dollar rate has remained at about \$ 2.80 throughout 1953 and the transferable sterling rates have been consistently high and also the fact that non-dollar, non-sterling countries have bought sterling for gold or dollars should not lull the Commonwealth to a false sense of security of sterling. It is necessary to take gradual and cautious steps rather than plump for outright convertibility. Formal convertibility of sterling with trade restrictions would not achieve much. Rather, the opening of commodity markets in London which enables non-resident holders of sterling to buy dollar goods would make a great contribution towards convertibility. Allowing sterling to find its own level would be taking a grave risk. Rather, a "floating rate" with safeguards against trade pressures and speculative pressures would be the appropriate objective to aim at. From the point of view of India proper adjustment of relations between the sterling area and the European Payments Union is far more important at this juncture than the search for sterling convertibility. Logically, currency convertibility in Europe, particularly sterling convertibility, would not be compatible with the functioning of the E.P.U. It would not clearly be safe to dismantle the E.P.U. mechanism of payments without putting something more stable and satisfactory in its place. At the same time it is difficult to appreciate the recent tendency on the part of some European countries which are in a strong creditor position in the E.P.U.—Belgium, Germany and lately also Switzerland—to demand a hardening of E.P.U.'s credit conditions (such as a change in the ratio of gold and credit and amortization of credits outstanding over a

certain period). It is impossible for the U.K., the holder of the sterling area's central reserves, to face a new drain on reserves through additional gold payments to E.P.U. To fight a possible recession European trade needs adequate credit. E.P.U. must also understand that the sterling area would receive the first blow of any recession and through counter-measures would weaken its impact on Europe. Should not the E.P.U. maintain its trade with the sterling area through easy credit conditions and thereby increase its capacity to fight a possible recession? Let us hope that the relations between the E.P.U. and the sterling area would be satisfactorily adjusted during the next few months on the basis of community of interest. In any case convertibility of a key currency like sterling would need large reserves to operate upon. The Randall Commission has suggested that the International Monetary Fund's holdings of gold and convertible currencies amounting to \$3.3 billion may be more actively utilized for this purpose. It has also suggested that the Federal Reserve System explore the possibility of 'standby credit' or 'line of credit' arrangements. It is difficult to say how far these recommendations can be, and would be, implemented in the near future.

The long-term expansionist policy as part of the collective commonwealth approach is also related to an important practical problem, viz. stabilization of prices of primary products on which the economic fortunes of the entire Commonwealth so largely depend. The violent movements in the sterling area's gold and dollar reserves after the war are broadly correlated with the ups and downs of primary prices. These ups and downs have unequal effects on the economies of industrial and primary producing countries of the Commonwealth respectively.\* This is as much a source of instability as of conflict of interest within the Commonwealth. Stabilization of primary prices through international action either in the form of Commodity Control Agreements or buffer stocks is not as easy matter. The Randall Commission's definite opposition to such schemes or, for that matter, to any price support programme, has made an international solution exceedingly difficult. This, however, does not mean that a Commonwealth solution is

---

\* It is well known that when the U.K.'s terms of trade are improving they are worsening in the rest of the sterling area and *vice versa*. There was worsening of the U.K. terms of trade in 1951 and recovery in 1952 and 1953 against the opposite movement in the rest of the sterling area.



impossible. India would naturally be interested in schemes which are aimed at the creation of balanced marketing conditions in respect of important primary commodities, specially the dollar-earners. Such schemes, on a selective basis, should be formulated, and the necessary machinery kept in readiness, to meet any situation that may arise in the event of a sharp recession having an immediate impact on primary prices.

#### INVESTMENT NEEDS AND SOURCES

Under India's Five Year Plan the estimate of resources available for investment is Rs. 35-36 billion in the aggregate. Of this Rs. 27-28 billion (77.5 per cent) is expected to be derived from domestic savings, Rs. 8 billion (22.5 per cent) is expected to be derived from foreign sources and Rs. 2.9 billion is expected to be derived from the agreed releases of sterling balances. Of the investment derived from foreign sources *assured* foreign aid amounts to Rs. 1.56 billion and additional foreign assistance *expected*, but not *assured*, is Rs. 2.54 billion. These figures represent no more than the order of magnitudes involved in the plan. About 4/5ths of the investment outlays would be derived from domestic sources. This would mean stepping up domestic savings from 5 per cent of the national income in 1950-51 to about 6.75 per cent of the national income in 1955-56. In a poor country like India even this increase of savings calls for a change of outlook on the part of the people and for institutional changes. Domestic savings needed may not be equal to the investment targets. A large part of foreign assistance is not assured. If both domestic and foreign sources of finance are not adequate the volume of investment will sink below the critical level, unless resort is had to deficit financing. The Government has now been receiving aid for economic development from the U.S.A., the U.K., Canada, Australia, New Zealand and Norway, among others. India's official sterling debt was extinguished during the last war. After the war foreign investment in India includes a larger proportion of direct investment which means that the transfer difficulty in times of falling export prices and falling foreign exchange receipts has been considerably lessened. During the post-war years India has incurred fresh foreign obligations in dollars amounting to \$ 300 million, exclusive of an obligation of \$ 100 to the International Monetary Fund. Nevertheless, the total amount of official foreign indebtedness is fairly small. In rupees

the dollar debt comes to about 1/4th of the prewar official sterling debt. Considering India's current balance of payments and taking into account that the investment will yield much more than the cost of servicing the debt, India's capacity to absorb foreign capital is at least as large as what is contemplated under the Five Year Plan.

The Randall Commission has said, "Underdeveloped areas are claiming a right to economic aid from the U.S. in proposals in the United Nations and the Interparliamentary Union. We recognize no such right." In view of this opinion which reflects the prevailing climate of opinion in the U.S.A., underdeveloped countries of the Commonwealth in the position of India may not bank upon U.S. economic aid. The Commission further says that loans may be given by the U.S. Government provided they cannot be obtained from private international sources and provided "economic aid is necessary in the interest of the United States." Private investment from the U.S. sources is inhibited by many difficulties connected, among other things, with the U.S. fiscal system. Moreover, such investment will presumably be available not for the public sector, but for the private sector of the Indian economy.

American private investment even within the limited field may not be available because, as the Randall Commission puts it, "American investors can hardly be expected to venture into countries and fields which local capital and enterprise consider unattractive and insecure." The very existence of a substantial public sector as in India, and regulation of industry in the interest of overall planning will be decisive factors.

The only source of Government leading would be the Export-Import Bank which, in the words of the Randall Commission, "should continue to make loans which are in the special interests of the United Nations."

With regard to American private investment another desideratum is not merely Most Favoured Nation treatment of foreign capital, but also National Treatment. If private investment should claim freedom from State regulation and control, so far as business operations are concerned, this should mean *better than National Treatment*, since domestic capital is subject to regulation in a mixed economy such as India's. To escape from this position the

American private investor would naturally want that he, along with the local investor, should be guaranteed full freedom of enterprise.

The International Bank as a source of external finance is not directly available as a source of finance for the private sector, because its loans must have a government guarantee. Moreover, it lends on the basis of individual projects, and not for general purposes of economic development. Its resources are also limited. Nevertheless, India has found the International Bank to be a very useful source of finance. Within two years India will owe the International Bank about \$100 million for loans already made on account of vital national projects.

In view of what we have already stated the role of the Commonwealth as a source of development finance is important both from the point of view of the underdeveloped parts of the Commonwealth and from the point of view of the Commonwealth's economic solidarity. Happily there are clear signs to show that the U. K. as the leader of the Commonwealth is alive to its grave responsibility in this respect.

In the U. K. applications to raise more than £ 50, 000 on the London market require the consent of the Treasury which is advised by the Capital Issues Committee, except in the case of borrowing by Commonwealth Governments, other than Canada, when Treasury decision is given after consideration of the views expressed by interested Departments. The Capital Issues Committee has now been asked to extend the usual criteria to take account of the U. K. Government's undertaking to provide additional capital for Commonwealth development and to give sympathetic consideration to projects which appear likely to contribute materially to the improvement of the sterling area's balance of payments with the non-sterling world. Between March and November, 1953 the U.K. Treasury has given permission for capital to be raised in London for investment in Commonwealth countries within the sterling area, amounting to over £ 35 million. India has already taken advantage of these investment facilities.

In March, 1953 the Commonwealth Development Finance Company was incorporated with an authorized capital of £ 15 million and borrowing powers up to twice this amount. The objects of this company are to "assist in the provision of financial



assistance for the development projects in the Commonwealth, more particularly projects designed to increase Commonwealth resources and strengthen the sterling area's balance of payments", to assist in providing "ready access to British industrial, financial and commercial experience", to cooperate with overseas financial agencies and capital markets in furthering its objects, and to co-operate with the International Bank for Reconstruction and Development. The operations of this company will be watched with great interest by India and other members of the Commonwealth.

In 1953 the United Kingdom Government took further action to expand the investment opportunities. It agreed to place at the disposal of the International Bank an amount up to £ 60 million over the next 6 years for Commonwealth development. The amount actually made available would depend, among other things, upon the number of suitable projects. The sterling for the purpose would come from U.K.'s 18 per cent subscription to the Bank. Utilization of this source of finance would naturally depend upon a number of conditions, such as (1) the borrowing country being able to put up a sufficient part of the cost of the project, (2) the probable effect of sterling release on the prospects of U.K. exports, (3) the prospect of ensuring supplies of raw materials needed by the U.K. industry, (3) the economic situation in the U. K. and (4) the extent to which the existing practice followed by the International Bank of buying sterling for dollars from the Bank of England continues. Sterling releases under this arrangement have already been approved for two Indian projects—the Damodar Valley project and an expansion of the plants of the Indian Iron and Steel Company. Both of them have been "retrospective" releases in the sense that loans already agreed to be made in dollars and not disbursed will now be disbursed in sterling. For the two schemes taken together the United Kingdom has offered to release £ 5 million.

It appears that the U.K. is not now short of capacity to meet the physical demands of the rest of the sterling area, and the sterling area countries now have an element of choice in that finance is now available in the London money market. It should now be possible, for example, for India to consult the U.K. about

the possibilities of sterling finance before entering into commitments in the dollar market. But the tendency to place too much emphasis on "projects", however, inhibits development in many cases, because projects cannot go alone. Emphasis should now shift to broad, but balanced, programmes of economic development. It is necessary that such programmes may be justified to the British Treasury before a loan is sanctioned, but it should not be a subject of discussion with subscribers to the loan. The Commonwealth Finance Company is understood to be charging an interest rate of  $5\frac{1}{2}$  p.c. which is bound to raise the cost of development; the rate should be based more on the gilt-edged market rate. But at the same time from the point of view of the investor the position can be more satisfactory if restrictions on repatriation of dividends, profits and capital were further relaxed. Conditions in India would not militate against the fulfilment of this requirement in the case of projects approved as part of the country's Five Year Plan.\* In any case, however, there should not be considerable disparity between the rate of interest paid on a sterling loan from the International Bank and the rate in the London money market. Another difficulty which is being currently experienced is that where only local currency is required the schemes are not eligible according to the criteria set by the United Kingdom. It is also necessary to consider how far sterling loans will be an advantage if they are "tied loans", although one would readily agree that the U.K. in sanctioning a loan would naturally take into account the amount to be spent on British products.

#### INDIA'S ECONOMIC RELATIONS WITH COUNTRIES OUTSIDE THE COMMONWEALTH

It appears from the table reproduced on page 4 above that India's large passive trade balance in relation to the dollar area and OEEC countries in 1952-53 was being offset by its active trade balance with the sterling area to some extent. The American wheat loan largely offset the large dollar deficit on trade, while the substantial deficit on trade with OEEC countries was almost offset

---

\* The *Banker* wrote in 1950 (November) that "at the moment the restrictions imposed on the entry and withdrawal of foreign capital by India, and most other Commonwealth countries in South Asia, are not noticeably more onerous than those imposed on foreign investment by the United Kingdom."

by the surplus on trade with the sterling area. India's trade with non-dollar, non-sterling countries and with dollar countries has considerable importance in the context of the present structure of its foreign trade. So long as the sterling area has a surplus with non-sterling, non-dollar countries and with the dollar area, the offsetting of India's deficit with these countries by its surplus with the sterling area does not impose an appreciable strain on the reserves of the sterling area. In fact such offsetting is desirable, for accumulation of sterling balances is not an unmixed blessing either for the U.K. or India. But if, as is not unlikely in the immediate future, the sterling area's dollar surplus dwindles to a small amount and/or its surplus with the rest of the world also dwindles and is possibly converted into a deficit, lack of free availability of non-sterling currencies will have a restrictive effect on imports from non-sterling, non-dollar countries, India is, therefore, directly interested in the progress towards sterling convertibility which may be achieved, although, as we have said, the prospects of this are rather gloomy on a rational estimation of possibilities.

Far less important than this issue of widening of the area of trade through removal of payments difficulties is the issue of Commonwealth preference. One must not, however, minimise perhaps the net gain derived by India from the operation of existing reciprocal preference. Nor should one fail to mention, as an offset, the irritation caused by Commonwealth preference in countries of southeast Asia which are outside the Commonwealth preferential system. In any case, as already stated above, the existing preferences are a bargaining counter in future tariff negotiations for the Commonwealth as a whole and for its individual members.

Southeast Asia is an important part of the world with which India has developed strong emotional and economic ties in recent years. This region has been meeting India's marginal requirements of food and has been an important market for India's low-priced textiles and many categories of manufactured goods in short supply. There is sometimes talk of development of intra-regional trade in this region in which India may take an important place. Such a development must follow the natural course of diversification of raw material or plantation economies of this region on the basis of a rational kind of regional division of labour rather than nationa



economic self-sufficiency. The forces of nationalism are today too powerful to admit of any kind of balanced regional development which is ultimately to the best advantage of all countries in this region. Where these forces are weak or are suppressed the set pattern of colonial development is bound to continue and divert trade to other continents. In these circumstances any deliberate attempt to evolve a regional trade *bloc* is bound to fail. Even trade agreements concluded between countries of south and southeast Asia (to which India has been a party) are merely make shift arrangements designed to overcome the payments difficulties in respect of trade as between the sterling countries and between the sterling countries and the non-sterling countries. They will disappear with the emergence of buyers' markets and the interconvertibility of key currencies. Similarly the suggestion of a regional payments union on the lines of E.P.U. is unrealistic so long as the trade of this region is strongly oriented towards other countries, so long as foreign banking, insurance, merchandising and shipping need clearing in foreign currencies, so long as the countries of this region are financially weak and so long as there are small possibilities of economic integration and cooperation.

What has been said of south and southeast Asia is perhaps more true of Japan. Although the prospect of India's stable trade relations with Japan is uncertain and obscure by reason of the fundamental instability of the postwar Japanese economy, yet there is no doubt that there is scope for a large volume of mutually advantageous trade not necessarily on the basis of formal economic agreements. India as much as the sterling area as a whole has now a stake in the development of trade with non-sterling countries like Japan. The sterling area can have access to Japan's large market for industrial raw materials, but it must in turn buy larger quantities of Japanese manufactures. So long as the 1948 payments agreement remained in force sterling balances in excess of a working balance (in practice about £17 million) had to be converted into dollars, and, therefore, the U.K. policy was aimed at keeping trade between Japan and the sterling area in equilibrium. Since there was always a tendency for Japan's current earnings of sterling to exceed its sterling expenditure the sterling area imports were reduced to essentials. Later when the dollar clause was abolished Japan could use sterling and accept sterling in transactions with the 'transferable account'

group of countries. But payments of sterling to Japan even for settlement of current transactions were subject to specific administrative control. The recent trade agreement concluded between the U.K. Government and Japan is calculated to free the channels of trade with Japan and enable the sterling area and the Commonwealth to stabilize the payments position in relation to Japan on the basis of expanded trade, at any rate, between the U.K. and its colonial territories, on the one hand, and Japan on the other hand.

India would be one with the Commonwealth as a whole in any attempt to impress upon the O.E.E.C. countries the necessity of pulling together in the face of the threatened recession. As we have argued above, certain members of E.P.U. most adopt good creditor policies in relation to the U.K. and the Commonwealth. India and many other members of the Commonwealth have been the beneficiaries of remarkable economic recovery in certain countries of Western Europe just as the latter have benefited from the expansion of their trade with the Commonwealth. India feels that this development should not be hampered by short-sighted policies with regard to the functioning of E.P.U. India is vitally interested in a wider system of trade and settlement of balances through which it may use its active balance with the tropical countries of Asia and Africa to finance at least part of its imports of capital goods from Western Europe which, in turn, should help Western Europe to finance its import surplus with the tropical countries. The present imbalance in the accounts of E.P.U. should be removed by encouraging triangular and multi-angular settlements of this kind based on a wider area of trade and payments arrangements. This object can not be achieved by means of preferential tariff arrangements which may link OEEC countries with the Commonwealth. The success of economic integration in Western Europe under normal conditions has to be demonstrated before such a step can be justified. It is clear that the ultimate objective is to create as large a free trade area as possible on the basis of non-discriminatory convertibility of currencies. Since the prospects of such a consummation are not clear at the moment no useful purpose will be served by possible preferential tariff arrangements, covering the Commonwealth and countries of Western Europe.

There are other reasons why such arrangements will be against India's economic interests. It is doubtful if the giving of a "secondary preference", as has been suggested, by reducing duties on European exports without nullifying the preferential advantage enjoyed by the U.K. (say, in India) will have a balance of advantage to commend it, apart from the fact that it violates the provisions of the *General Agreement on Tariffs and Trade* (GATT). The GATT is expected to be revised in the course of the present year as soon as the main lines of the U.S.A.'s foreign economic policy are seen more clearly. But in any case it will not be possible for India to subscribe to the view that the granting of new preferences would contribute to the lowering of tariffs. In this connection a few words may be said about certain requirements on which India may insist at the time when the GATT is being revised. Revision of the GATT can not mean the abandonment of the Most Favoured Nation clause in the form in which it has been acceptable. The wider code of commercial conduct which the GATT lays down may, however, have to be regarded as unrealistic in the light of the non-fulfilment of the basic conditions for its general acceptance. The continued balance of payments difficulties which have bedevilled national economies have darkened the prospects of development of non-discriminatory, multilateral trade. It seems clear that without a better structural balance of the world economy based on the closing of the gap in the levels of productivity (in which solid progress has already been made) non-discrimination in trading relations has not much chance of being realized as a desirable principle of commercial conduct. This, however, does not mean that there should be no forum for consultation on matters of trade disputes, or that broad trade policies should not be formulated for the acceptance of national legislatures, or that renegotiation of the GATT with a view to lowering the trade barriers should not be attempted. In the particular case of India renegotiation of tariff rates has now become necessary for several compelling reasons. So far quotas in India have been justified by balance of payments reasons. Reducing imports by quotas has been necessary for the purpose of conserving foreign exchange. But adventitious protection afforded by quotas has in many cases raised difficulties for consumers of final commodities or basic raw materials. Enlightened economic opinion in India (reflected now in Government's policy-making) is in favour of substituting tariffs for quotas. Such substitution will mean



tariff rates higher than those bound under the GATT. Since there is greater flexibility of trade under tariffs than under quotas, *higher tariffs without quotas* would be much more conducive to expansion of international trade than the *low tariff rates* bound under the GATT, *combined with quantitative import restrictions* which have tended to become universal and persistent. The requirements of development finance will also have to be met by raising duties on articles the import quotas of which have been liberalized and will have to be further liberalized. In fact while this will rationalize protection through the release of market forces, Government revenue will be augmented by a method of taxation which is perhaps least irksome and which will compensate the treasury for the considerably diminished yield of export duties resulting from the abolition or reduction of export duties in the face of the emergence of a buyers' market.

---











UNIVERSITY PRESS  
UNIVERSITY BUILDINGS  
DELHI 8